

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-103659-07

Date: January 23, 2008

Company =

H =

W =

Trust 1 =

Trust 2 =

Beneficiaries =

State =

a =

b =

c =

d =

e =

f =

Dear :

This letter responds to your letter dated November 15, 2006, and subsequent correspondence, requesting a ruling under § 1362(f) of the Internal Revenue Code.

### FACTS

The information submitted states that Company was formed on a, under the laws of State. Upon formation, Company filed Form 2553, Election by a Small Business Corporation, to be treated as a subchapter S corporation. Company's initial shareholders were two grantor trusts described in § 1361(c)(2)(A)(i): Trust 1, the deemed owner of which was H, and Trust 2, the deemed owner of which was W.

H died on b, and Trust 1 became an irrevocable trust with W as its sole beneficiary. Company represents that Trust 1 qualified as a qualified subchapter S trust (QSST) and was treated as though a timely QSST election had been made. However, W failed to properly file the QSST election.

On e, W died. Upon W's death, the Beneficiaries became beneficiaries of both Trust 1 and Trust 2. According to Company, Trust 1 intended to be treated as an electing small business trust (ESBT) as of e. Company represents that Trust 1 qualified as an ESBT and has been treated as though a timely ESBT election had been made. In addition, Trust 2 also intended to be treated as an ESBT. Company represents that Trust 2 qualified as an ESBT and has been treated as though a timely ESBT election had been made. However, the trustees of Trust 1 and Trust 2 failed to properly file the ESBT elections.

Company further represents that the circumstances resulting in the termination of Company's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Company and its shareholders have agreed to make such adjustments, consistent with the treatment of Company as an S corporation, as may be required by the Service.

### LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Prior to January 1, 1997, § 1361(c)(2)(A)(ii) provided that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 60-day period beginning on the day of the deemed owner’s death. If the entire corpus of such trust is includible in the gross estate of the deemed owner, § 1361(c)(2)(A)(ii) shall be applied by substituting “2-year period” for “60-day period.”

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i); (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made; and (C) for purposes of applying §§ 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States. A substantially separate and independent share of a trust within the meaning of § 663(c) shall be treated as a separate trust for purposes of §§ 1361(d) and 1361(c).

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the QSST election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides, in part, that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Company's election to be treated as an S corporation terminated on c, upon the failure by the beneficiary of Trust 1 to properly file a QSST election for Trust 1. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, Company will be treated as continuing to be an S corporation from c, and thereafter, provided that Company's S corporation election is not otherwise terminated under § 1362(d). Moreover, Trust 1 will be treated as a QSST from c, through d. Additionally, Trust 1 will be treated as an ESBT from e, and thereafter, provided the trustee of Trust 1 files an ESBT election for Trust 1 with the appropriate service center, effective e, within 60 days of the date of this letter. Trust 2 will be treated as an ESBT from f, and thereafter, provided the trustee of Trust 2 files an ESBT election for Trust 2 with the appropriate service center, effective f, within 60 days of the date of this letter. A copy of this letter should be attached to those elections.

This ruling is contingent on Company and all its shareholders treating Company as having been an S corporation for the period beginning on c, and thereafter. The shareholders of Company must include their pro rata share of the separately stated and nonseparately computed items of Company as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by Company as provided in § 1368. If Company or Company's shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether Company is otherwise eligible to be treated as an S corporation or whether Trust 1 and Trust 2 are eligible to be treated as a QSST and an ESBT respectively.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Company's authorized representative.

Sincerely,

/s/

Tara P. Volungis  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes